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Dynamics and Scope of International Trade of Bhutan

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ABSTRACT

Bhutan is a small economy highly open to foreign trade which represented 76percent of its GDP IN 2020 (World Bank -22) Bhutan has been involved in a sub-regional economic cooperation process for several years , being a member of regional organisation. It joined the world trade organisation in 1999. Bhutan in the 21st century is an integral component in the South Asian trade and commerce machinery. Bhutan's trade, exports and importsindustry has flourished during the 8th and 9th five-year plan, and is slowly but surely making its mark on the SAARC economy. Bhutan predominantly had trading relations with India after the 1960 ban on Tibet. In 2002, India built the second hydroelectric project in Bhutan, and thereafter dominated about 90% of the nation's exports. However, imports have diversified into Egypt and Latin America since. Bhutan imports crude marbles from Egypt, vegetable products from Brazil, copper wires from Cyprus and medical equipment from Finland, to name a few. In 2007, cars were imported from Kuwait and cell phones were imported from Sudan. Currently Bhutan is importing more than eighty nine percent capital as well as consumer goods from India.

KEYWORD: GROSS DOMESTIC PRODUCT, SUB REGINAL ECONOMIC COOPERATION, SAARC

INTRODUCTION

Bangladesh is the second largest export market for Bhutan, with a share of about 3.2 percent in 2009 and its share in imports reduced from 4.7 percent in 2008 to 2.2 percent in 2009.(RMA of Bhutan – Annual Report 2009/2010)

The dominance of bilateral trade with India reflects Bhutan's limited ability to diversify its export markets. This creates a problem in its trade with third countries, as nearly 16 percent of imports are paid in convertible currency, while less than 5 percent of exports earn convertible currency. This mismatch between the earning and spending of hard currency leads to a severe foreign exchange constraint, which continues to plague the Bhutanese economy even as trade with India flourishes. Nearly three fourths of all export earnings are derived from activities based primarily on indigenous natural resources, such as electricity generated by hydropower, foodstuff originating from land and wood products based on forest resources and minerals.

The most important category of imports is capital goods, which over the last decade have accounted for 40 to 50 percent of all imports. However, while the aggregate import of capital goods has increased, the amount from countries other than India has declined in relative terms.

Meanwhile a large amount of resources are tied up in the reserves instead of being used to import essential machinery and intermediate goods required for manufacturing activities. Clearly a trade-off exists between current needs and future contingencies, and authorities will have to constantly re-evaluate this trade- off, lest excessive caution unduly holds back the pace of industrial progress.

The importance of foreign trade statistics is instrumental in gauging the overall economic performance in relation with other countries. Foreign Trade Statistics are vital to the policy maker, the economic planner and the public in general. The data related to merchandise is being compiled by the Department of Revenue and Custom, Ministry of Finance and the services by the Royal Monetary Authority of Bhutan. Balance of Payments statistics are designed to show the difference between the total payments made to foreign countries and the total receipts from foreign countries. Thus, it provides systematic summary of economic transaction, for a specific time period, between an economy and the rest of the world. The transactions included goods, services, income, transfers and financial claims. Balance of payments statistics in Bhutan are compiled by the Royal Monetary Authority based on information from its own accounts and those of the Banks, together with information on imports and exports.

The trade regime of Bhutan has been characterized by an extremely high degree of openness, strengthened by a bilateral Free Trade Agreement with India for three decades. The non-Indian part of Bhutan's import trade, which has varied from 20 to 30 percent of total imports, was subject to severe quantitative restrictions until 1990. However, since the early 1990s this part has also begun to be gradually liberalized, as the country moved away from such restrictions toward taxes and tariffs, allowing the market mechanism a greater role in the allocation of resources. Trade liberalization has, however, only had the limited effect of converting quotas into tariffs but not of reducing tariffs as such. On the contrary, the rates of sales tax and customs duty on imported goods were revised upward in 2004 by an average of 30 percent.

By far the most important source of restrictions on free trade lies in the limitations imposed on the use of convertible currency. These restrictions are prompted, however, not by a conscious design to protect a set of targeted industries—chosen by some criterion such as infant industry protection or externalities. Rather, their sole objective is to ration the use of limited supply of convertible currency.

From a virtually closed economy in 1960, Bhutan has completely transformed itself in the subsequent decades into a classical case of a small open economy characterized by a high degree of dependence on trade (1). Already by the early 1980s, when systematic statistics were first collected, the combined export and import trade of Bhutan amounted to 55 percent of its GDP—a far greater trade ratio than anything observed in the rest of South Asia. Over time, the dependence on trade became even greater until the trade ratio reached nearly 74 percent in the second half of the 1990s and 87 percent in 2009. The trade ratio has gone high in the present period because of the commissioning and exporting electricity to India from the Tala hydro electric project.Choden and Penjore (2004) reveal, "The first recorded Indo-Bhutanese trade link was established in the post turmoil of Cooch Behar annexation by Bhutan and the subsequent peace initiatives, which culminated into the Anglo-Bhutanese Treaty of 1774. This treaty made it possible for the Bhutanese traders to visit Bengal to sell and buy goods; this can be considered a rudimentary from of export-import reported between Bhutan and India." The main items sold by the Bhutanese traders in Bengal included china silk, cowtails, tungun ponies, wax, walnuts, musk lac, madder, coarse blankets, silver and stripped woolen cloth. From Bengla, Bhutanese bought indigo, cloves, cardamom, nukher, camphor, sugar, broadcloth, copper, goat-skins, endy and coarse cloth, snadalwood, dreid fish and tobacco. Choden and Penjore (2004)[1] note that the British also established trade relations with Bhutan through the 19th century treaty with Tibet, which opened the Indian trade post at Yatung and it was through Chumbi valley in Tibet that the traders from India could approach wetern Bhutan. Until 1958, Bhutan's major trade link was with Tibet. Fixed routes via passes and valleys were used, for example, Paro's trade followed the low pass of Termo La, while the merchants of Punakha traveled up the valley of the Mo Chu to Lingshi La on their journey to Gyantse and Shigatse. Yatung and it was through Chumbi valley in Tibet that the traders from India could approach wetern Bhutan. Until 1958, Bhutan's major trade link was with Tibet. Fixed routes via passes and valleys were used, for example, Paro's trade followed the low pass of Termo La, while the merchants of Punakha traveled up the valley of the Mo Chu to Lingshi La on their journey to Gyantse and Shigatse. Traders of eastern Bhutan mostly followed the Lhodrak River. The exports of Bhutanese merchants were mainly rice, silk fabrics, vegetables dyes and brass utensils, while the imports items from Tibet are salt, wool and precious metals. The trade routes between Bhutan and Tibet were finally closed in 1960 owing to the political tension between Tibet and China. The Indo-Bhutan treaty of August 8,1949 forms the basis for formal trade relations between the two countries. The Treaty consists of eight articles. Article 5 says, "There shall, as heretofore, be free trade and commerce between the territories of the Government of India and of government of Bhutan; and the Government of India agrees to grant the Government of Bhutan every facility for the carriage, by land and water, of its produce throughout the territory of the Government of India, including the right to use such forest roads as may be specified by mutual agreement from time to time." This helped in redirecting Bhutan's trade towards India. Based on this backdrop, Indo-Bhutan relations began to assume concrete form following state visits made by the third king, His Majesty Jigme Dorji Wangchuck to India, and by Prime Minister Jawaharlal Nehru to Bhutan in between 1954 to 1961. Besides emphasizing India's recognition of Bhutan's independence and sovereignty in his public statement in Paro, Nehru's visit in 1958 was also significant with discussions initiated for development cooperation between the two countries. With the construction of lateral roads linking the Bengal-Assam plains to Phuentsholing to Thimphu and Paro in 1962, a new era in Bhutan's foreign trade commenced. The Agreement on SAARC Preferential Trading Arrangement (SAPTA) was signed on 11 April 1993 and entered into force on 7 December 1995, with the desire of the Member States of SAARC (India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan and the Maldives) to promote and sustain mutual trade and economic cooperation within the SAARC region through the exchange of concessions. The establishment of an Inter-Governmental Group (IGG) to formulate an agreement to establish a SAPTA by 1997 was approved in the *Sixth* Summit of SAARC held in Colombo in December 1991.

[1]*Choden, T. & Penjore, D. (2004). Economic and Politic al Relations Between Bhutan and Neighbouring Countries. Thimphu: Centre for Bhutan Studies.*

South Asian Free Trade Arrangement (SAFTA)
SAFTA was signed at the 12th SAARC Summit held in Islamabad, Pakistan in January 2004. SAFTA has been formulated to broaden trade relations within the region and to lower import tariffs among the member countries. The main aims of the arrangement include liberalizing trade and removing tariffs in intra-trade and for promoting welfare of people in South Asia, broadening economic cooperation and ensuring equitable distribution of trade and cater to the special needs of small and least developed members by providing them special and differential treatment. Member states have been accorded different durations to lower their customs tariffs between 0% and 5%, 7 years for India and Pakistan, 8 years for Sri Lanka, and 10 years for Nepal, Bhutan, Bangladesh and Maldives.

Bangladesh-Bhutan-India-Nepal Quadrilateral Growth Initiative (BBIN-GQ)
At sub-regional level, BBIN-GQ was formed to accelerate the pace of economic development in member countries through the identification and implementation of specific projects. The sectors identified for priority attention are multi-model transportation and communication, energy, optimal sustainable utilization of natural resource endowments, trade and investment facilitation and promotion and tourism and environment. Although the growth quadrangle pursues objectives beyond trade, very little progress has been made in other areas of cooperation such as poverty eradication, social welfare and improvement in the quality of life.

Trade and Commerce Agreement of 1995
The issue of trade between Bhutan and India is guided by the Trade and Commerce Agreement of 1995which provides free trade between the two countries. However, if deemed necessary, the Bhutanese government may impose non-tariff restrictions on the entry of Indian goods to protect its industries in Bhutan. Further, both governments can impose non-tariff restrictions on the entry of goods of third country origin into their territory. Bhutan is a very small economy in South Asia, but it has rapid economic growth rate of 8%in 2005, 14% in 2006, and 22.4% in 2007. As a landlocked country, Bhutan depends on foreign aids for financing its developmental programmes and establishment costs, where India has been the largest donor of external aid and its main development and trading partner. Bhutan and India signed a free trade agreement in 2008, which allowed Bhutanese imports and exports from third markets to use India as transit without tariffs. Bhutan is an agricultural economy, but it exports electricity, cardamom, gypsum, timber, handicrafts, cement, fruit, precious stones and spices, and imports fuel, lubricants, grain, machinery, vehicles, fabricsand rice. In 2007, the main export partners of Bhutan were India (58.6%), Hong Kong (30.1%), Bangladesh (7.3%); and major import partners were India (74.5%), Japan (7.4%) and Sweden (3.2)

Bhutan remained practically closed to the outside world until the 1960s at which point King Jigme Dorji Wangchuck initiated efforts to increase links with the greater world. Up to that time, Bhutan's trade, limited by low marketable surpluses of self-sufficient communities, was mainly with Tibet and based on barter. Bhutan exchanged rice for salt, wool, tea and precious metals. Free trade between India and Bhutan has a long tradition, but was confined mainly to the southern region of Bhutan, which had an extended border with India. With the closure of the border with Tibet in the early 1960s, a complete re-orientation of trade towards India was necessary. The foundation for this reorientation was laid down by the Five-Year Development Plans launched in 1961. The first two Plans emphasized establishing basic infrastructure aimed at reducing Bhutan's physical isolation and improving internal communications, while also building up the institutions of a modern economy and state, especially through education and training. Better communication made trade more feasible, which in turn prompted increased monetization and opened the way for more specialization in production. A striking example of such specialization has been a trend towards the production of horticultural crops for export, complemented by an import of rice. Spurred by better communication and the availability of low-cost Indian labour, most industrial development took place near the Indian border. Subsequently, with the development of hydropower in the mid-1980s, an entirely new dimension was added to the pattern of trade between Bhutan and India, with far-reaching consequences for the overall development of the Bhutanese economy.

India is by far the most important trading partner with Bhutan, and its role has increased over the years. In the early 1990s, about 88 percent of all exports were destined for India, and in 2009, that proportion has risen to 93.50. During the same period, India's share in imports increased from 74 percent to 77.85 Percent.

Trade trend in Bhutan
From a virtually closed economy in 1960, Bhutan has completely transformed itself in the subsequent decades into a classical case of a small open economy characterized by a high degree of dependence on trade (1). Already by the early 1980s, when systematic statistics were first collected, the combined export and import trade of Bhutan amounted to 55 percent of its GDP—a far greater trade ratio than anything observed in the rest of South Asia. Over time, the dependence on trade became even greater until the trade ratio reached nearly 74 percent in the second half of the 1990s and 87 percent in 2009. The trade ratio has gone high in the present period because of the commissioning and exporting electricity to India from the Tala hydro electric project.

Period	Export – GDP Ratio(%)	Import – GDP Ratio(%)	Trade/GDP Ratio(%)	Trade Gap/GDP (%)
1981-1984	11.2	44.3	55.6	-33.1
1985-1989	21.3	41.7	62.6	-20.4
1990-1994	27.7	40.6	68.3	-13.0
1995-1999	32.6	41.0	73.7	-8.4
2000-2004	21.9	37.6	59.4	-15.7
2005-2009	43.0	44.4	87.4	-1.4
2005-2006	31.3	47.2	78.4	15.8
2006-2007	46.2	46.7	92.9	-0.5
2007-2008	56.3	43.9	100.1	12.4
2008-2009	41.3	43.1	84.4	-1.8
2009-2010	39.8	42.1	81.9	-2.3

What is especially remarkable about this upward trend in the importance of trade relative to GDP is that almost all the increases in the trade ratio resulted from faster growth of exports rather than of imports. The import-to-GDP ratio increased slightly from 44 percent in the early 1990s to 44.4 percent in the second half of the 2000s, whereas the export-to-GDP ratio tripled during the same period—rising from 11 percent to 43 percent. In the first half of 2000, both export ratio and import Ratio have fallen somewhat from the giddy heights of the late 1990s, but they again return to their level because of the incitation of number of economic activities like fast growing construction work, and the commissioning of the Tala project. While the trade ratio has grown strongly, the trade gap has come down just as sharply. While the gap between imports and exports amounted to a colossal 33 percent of GDP in the early 1980s, by the late 2010 s it came down to just 2 percent. Although the downward trend was slightly reversed in subsequent years, the trade gap as a proportion of GDP is still less than half of what it was in the early 1980s. Underlying both the upward trend in the volume of trade relative to GDP and the downward trend in the trade gap relative to GDP is the exceptionally fast increase in the volume of export. Despite the rapid growth of exports, however, trade deficits have remained large as a result of the very high level of imports, which stems from the continued inability of Bhutan's economy to expand its productive base (outside the power sector). Even after including the earnings from 'invisibles', which essentially means earnings from tourism, the current account deficit remains large and growing in absolute terms.

CONCLUSION

A large amount of resources are tied up in the form of reserves instead of being used to import essential machinery and intermediate goods required for manufacturing activities. There is clearly a trade-off here between current needs and future contingency, and the authorities will have to constantly re-evaluate this trade-off, lest excessive caution should unduly hold back the pace of industrial progress. The trade regime of Bhutan has been characterized by an extremely high degree of openness, buttressed by a bilateral Free Trade Agreement with India which has been in existence for over three decades.

The non-Indian part of Bhutan's import trade, which has varied in the range of 20–30 percent of total import, was, until recently, subject to quite severe quantitative restrictions. However, since the early 1990s this part also began to be gradually liberalized, as the country began to move away from quantitative restrictions towards taxes and tariff, as part of a broader move towards allowing the market mechanism a greater role in the allocation of resources. Trade liberalization has, however, had only the limited connotation of converting quotas into tariffs but not reduction of tariffs as such. Installation of two potato grading machines worth of Nu. 14.4 million at the Food Cooperation of Bhutan Ltd's Auction Yard, Phuntsholing to improve online potato trading in the country. The grading machines are currently in full operation. Till date, around 12 traders and 162 farmers participated in the online auctioning of potatoes. The installation of grading machines has significantly improved online potato trading by reducing transaction cost and enhancing price transparency. A grant support of Nu. 960,000.00 to the Agency for Promotion of Indigenous Crafts for promotion of textile industry in the country. The grant support has helped six raw material banks in eastern Bhutan to maintain adequate stock and more varieties of yarn in the yarn banks. The support has enabled 248 weavers and the community to procure yarns from their door step and have access to cheaper raw materials. Training on international trade, export promotion, financial management, human resource management, business incubation center management on product design, packaging, branding & marketing, pasture development, financial management, food processing and livestock management for 287 officials from trade & trade related sectors, entrepreneurs and exporters. The training was aimed at enhancing knowledge and skills of the participants in their respective fields.

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